THE OFFICE OF REGULATORY STAFF

DIRECT TESTIMONY

OF

CAREY M. FLYNT

June 25, 2009

DOCKET NO. 2009-4-G

**ANNUAL REVIEW OF
PURCHASED GAS ADJUSTMENT AND GAS
PURCHASING POLICIES OF
PIEDMONT NATURAL GAS COMPANY, INC.**

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IN RE: ANNUAL REVIEW OF PURCHASED GAS ADJUSTMENT AND GAS PURCHASING POLICIES OF PIEDMONT NATURAL GAS COMPANY, INC.

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND OCCUPATION.

A. My name is Carey M. Flynt. My business address is 1401 Main Street, Suite 900, Columbia, South Carolina 29201. I am employed by the Office of Regulatory Staff ("ORS") as the Manager of the Gas Department.

Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A. I received a Bachelor of Science Degree in Business Administration, with a major in Accounting, from the University of South Carolina. I was employed at that time in the electric and gas utility industry and gained twenty five years' (25) experience in this field. In October 2004, I began my employment with ORS. I have testified on numerous occasions before the Public Service Commission of South Carolina ("Commission") in conjunction with natural gas issues.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to address the purchasing policies of Piedmont Natural Gas Company, Inc. ("Piedmont" or "Company"), including the hedging program, the administration of Gas Cost Recovery Mechanism ("GCRM") and the Industrial Sales Program (ISP).

Q. WHAT IS THE REVIEW PERIOD FOR THIS PROCEEDING?

A. The review period is the twelve-month period April 1, 2008 through March 31, 2009.

Q. PLEASE DISCUSS PIEDMONT'S PURCHASING PRACTICES.

A. Piedmont must purchase interstate pipeline transportation capacity, storage service and commodity supply to meet the demands of its firm customers on a peak day as well as to meet all of its firm and interruptible customers' annual usage requirements. Piedmont has firm transportation capacity on three (3) upstream interstate pipelines, including Transco, Columbia Gas and East Tennessee Transmission. The Company has firm contracted commodity supply from multiple sources, storage service on various interstate pipelines and operates two peaking liquefied natural gas ("LNG") facilities to meet its firm obligations. Since it is imperative that the volume of gas required for the firm class of customers be available on the peak day, it would be imprudent for the Company's plans to include the use of interruptible resources for transportation capacity, storage service or commodity supply to meet this obligation. Customers, who are dependent upon firm natural gas service for heating, cooking, water heating and other essential needs, expect the natural gas supply to be available. These firm customers have no alternate fuel capability and must have natural gas available 365 days a year.

Q. PLEASE DESCRIBE PIEDMONT'S CAPACITY AND SUPPLY CAPABILITIES FOR THE REVIEW PERIOD.

A. For the 2008/2009 winter period, the Carolinas System Design Day Firm Sendout was 1,329,494 dekatherms. For the Carolinas System, Piedmont had firm send out capacity and supply capability available totaling 1,395,978 dekatherms. This included firm transportation, contracts with suppliers, and contracted storage service on the Transco, Columbia and East Tennessee gas systems. Additionally, Piedmont had its own LNG facilities available to flow additional natural gas into the system when needed to balance flowing supplies with system load requirements.

Q. DID ORS CONCLUDE THAT THE COMPANY ACTED PRUDENTLY IN PURCHASING SUPPLIES AND CONTRACTING FOR CAPACITY TO MEET THE REQUIREMENTS OF ITS FIRM CUSTOMERS?

A. Yes. The Company uses what they refer to as a "best cost" gas purchasing policy. This policy consists of five main components -- price, security, flexibility, deliverability and supplier relations. These components are all interrelated and weighed based on their importance. Piedmont has been very active in purchasing supplies directly on the market and making arrangements through interstate pipelines for the delivery and storage of these supplies. ORS's observations of Piedmont's gas purchasing policies indicate that Piedmont is continuing its efforts to get the best terms available through negotiations of their contracts. In addition, ORS believes Piedmont has used the spot market to prudently purchase supplies at prices competitive with industrial alternate fuels. Piedmont has also been very active in FERC proceedings concerning transportation and storage rate changes by the interstate pipeline companies.

Q. PLEASE DISCUSS PIEDMONT'S HEDGING PROGRAM?

A. Piedmont's original hedging program was approved by the Commission on March 26, 2002 in Order No. 2002-223 in Docket No. 2001-410-G. This order allowed the hedging of up to sixty percent (60%) of the Company's annual normalized sales volumes. On May 25, 2005 the Commission issued Order No. 2005-287 in Docket No. 146-G approving limited modifications to the hedging program in order to increase Piedmont's flexibility to utilize fixed-price instruments and complimentary options transactions in making both time-driven and price-driven hedges. On October 11, 2006, the Commission issued order No. 2006-527 in Docket No. 2006-4-G which modified Piedmont's PGA or GCRM to reflect hedging activity results in the deferred account #253.04 on a monthly basis as requested by ORS. By Petition dated November 25, 2008, Piedmont sought approval to reduce the hedging "horizon" utilized under the Plan from twenty-four (24) months to twelve (12) months. Upon approval of this modification, set forth in Commission Order No. 2009-37, dated February 11, 2009, Piedmont is now approved to hedge gas costs out to a period 12 months in advance of the current period under the provisions of the Plan.

Q. WHAT CONCLUSION DID ORS REACH IN ITS REVIEW OF PIEDMONT'S HEDGING PROGRAM?

A. For this annual review period, the Company's hedging program for South Carolina operations resulted in a net cost of $26,349,589 being recorded to deferred account # 253.04. Individual cost components of the program are shown in Company witness Robert L. Thornton's Exhibit_____(RLT-2) and ORS witness Daniel F. Sullivan's Audit Exhibit____(DFS-3). ORS determined that Piedmont operated its hedging activities in compliance with the Commission approved program.

Q. DID ORS REVIEW THE COMPANY'S FORECASTED FUTURE REQUIREMENTS AND THE COMPANY'S STEPS TO MEET THIS DEMAND?

A. Yes. ORS reviewed the Company's forecasted future firm peak design day demand requirements and the measures the Company is taking to ensure the reliability of these supplies and their deliverability. Piedmont has taken a number of steps in securing firm supplies for future demand on its system. These steps include negotiating with interstate pipeline companies for capacity on their systems, acquiring additional storage capacity, and negotiating contracts with suppliers. As presented in Piedmont's 2008 PGA review, the Company had planned to construct a new LNG facility with Maximum Daily Withdrawal Quantity (MDWQ) of 125,000MCF to be available in the 2012/2013 winter heating system. On March 9, 2009, Piedmont announced that its previous plans to commence construction of its Robeson Liquefied Natural Gas (LNG) storage facility would be put on hold. Upon review of projections of Piedmont's Design Day Firm requirement through 2014, ORS does not take exception to the Company's construction delay. Piedmont has an obligation to maintain adequate supplies at just and reasonable costs to serve its customers. Based on our review of information provided by Piedmont, ORS believes that the Company is prepared to meet this responsibility. For future planning periods, ORS recommends that the Company continue its practice of monitoring its firm transportation, storage, supply and LNG capabilities in tandem with its forecasted demand and in conjunction with the many changes continuing to occur in the natural gas industry.

Q. PLEASE DESCRIBE PIEDMONT'S APPROVED GAS COST RECOVERY MECHANISM.

A. The purpose of Piedmont's GCRM is to permit the Company to recover the prudently incurred actual cost of gas from its customers. The actual cost of gas consists of two components, a Demand cost of gas and a Commodity cost of gas. The Demand component includes all capacity charges for the transportation and storage of gas. The Commodity cost of gas component is comprised of charges for the volumes of gas purchased. Commodity charges are not associated with the capacity charges for transportation and storage. The GCRM provides that Piedmont establish a Benchmark Commodity Cost of Gas which is the Company's estimate or forecast of the City Gate Delivered Cost of Gas for gas supplies, excluding Demand Charges. The GCRM provides for the recording of the monthly differences between the actual cost of gas purchased and the rate billed to the customer into the Company's Deferred Account # 253.04. Details of this account are discussed in the testimony of ORS witness Daniel F. Sullivan.

Q. DOES PIEDMONT'S APPROVED GAS COST RECOVERY MECHANISM ALLOW FOR ADJUSTMENTS TO THE BENCHMARK COMMODITY COST OF GAS?

A. Yes. The Benchmark Commodity Cost of Gas may be adjusted from time to time to recognize changes in this billing factor for the amount to be recovered. These requests are filed with the ORS for review and the Commission for approval. The GCRM also allows for the same type adjustment to the Demand Cost of Gas Component, although the Demand Component does not change as frequently as the Commodity Cost of Gas Component.

Q. WHAT IS THE CURRENT BENCHMARK COST OF GAS INCLUDED IN THE COMPANY'S RATES?

A. The current benchmark commodity cost of gas, GCRM # 126, included in the company's rates is $6.50 per dekatherm which became effective with the first billing cycle of February 2009. ORS does not recommend any change to the benchmark cost of gas at this time.

Q. HOW DO PIEDMONT'S GAS COSTS RECOVERY MECHANISM AND INDUSTRIAL SALES PROGRAM COMPARE TO THOSE OF THE OTHER GAS UTILITIES UNDER THE COMMISSION'S JURISDICTION?

A. Piedmont's GCRM and Industrial Sales Program are somewhat different from the operation of the one other South Carolina gas utility. The major difference is Piedmont has the opportunity to recover negotiated losses from its competitive industrial customers. Because the maximum published rates may not be competitive at all times, Piedmont utilizes negotiated prices for sales or transportation service to customers that would otherwise utilize alternate fuels. Due to the opportunity Piedmont has to recover negotiated losses through the operation of the deferred account, it is necessary that Piedmont negotiate its rate to industrial customers only to the level that is competitive with the alternative fuel prices without going below the Company's actual cost of the gas. Piedmont utilizes its monthly average cost of gas as the basis for negotiations of monthly sales service and will not negotiate a sales price that is lower.

Q. DID ORS FIND THAT THE COMPANY HAS BEEN NEGOTIATING PRICES WITH THE INDUSTRIAL CUSTOMERS ONLY TO THE LEVEL WHICH IS COMPETITIVE WITH THE ALTERNATE FUELS AND NOT BELOW THEM?

A. Yes. When Piedmont is negotiating its rate to compete with alternate fuels, the Company ensures three objectives are met. These are:

- The quoted rate does not undercut the cost of the alternate fuel;
- The most accurate market prices are utilized for both alternate fuels and natural gas; and
- The highest possible margin is negotiated.

The first step to ensure that Piedmont does not undercut alternate fuel prices is to identify the reasonable range of costs for specific alternate fuels early in the negotiation process. A number of alternate fuel prices are identified by Piedmont's account representatives and entered into an online database. Both Piedmont management and account representatives have real time access to these alternate fuel prices in a format that allows the comparison of prices available to various customers at various locations across the service area. The comparison of these customers' alternate fuel costs allows Piedmont to identify the range of market prices of various types of fuel and to identify customer submitted alternate fuel prices that do not fall in an expected cost range. Piedmont contacts these customers again and requests verification of alternate fuel prices when the prices supplied by the customer are lower than expected. Additional resources are available to identify the market pricing for alternate fuels. These resources include various Internet sites such as the Energy Information Administration, NYMEX, Amerada Hess, WTRG Economics, Industrial Fuel, Enline Energy, Horizon Energy, and Oil Energy. When Piedmont is negotiating its transportation rate, Piedmont utilizes two sources to understand the market cost of gas provided by a third party marketer. These sources include NYMEX for the commodity cost and internal gas supply personnel to identify a reasonable location basis cost. If the Company thinks quoted total delivered price for natural gas is excessive, the Company will offer a negotiated price based on what the Company determines to be reasonable**.** It is important to understand that Piedmont's approved negotiating process does not allow the Company to retain all loads each month, but it does allow the Company the opportunity to provide natural gas sales and transportation service to avoid lost sales in the market place.

Q. WHAT IS ORS'S POSITION WITH REGARD TO PIEDMONT'S PROPOSED CHANGES TO THE IMBALANCE PROVISIONS TO THE TRANSPORTATION TARIFFS?

A. ORS supports Piedmont's request to consolidate the provisions found in each of its transportation rate schedules addressing customer intra-month and end-of-month imbalances, liquidation of those imbalances through cash out, and utilization of third party agents by transportation customers into Rate Schedule 207. Piedmont has clarified and strengthened the language in its tariffs addressing intra-month imbalances. The revision addresses intra-month imbalances to ensure that it is absolutely clear that such imbalances are permitted only for operational reasons. ORS has reviewed these revisions and supports Piedmont's request.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.